Draft 2000 budget rejected in the first reading

Vol. 5, No. 147, November 8, 1999

"The economy that has given 26 percent of GDP as budget revenues within nine months, must give 36 percent - only some 15 billion more. My only question is: why not 150?"
Victor Pynzenyk, ex-vice prime minister of Ukraine

As Ukrainian citizens and selected politicians are counting costs and benefits of whatever choice they prepare to make next Sunday in the presidential election run-off, the majority of members of the Ukrainian parliament have "issued a no-confidence vote" on the government's claims of economic growth by means of voting down the draft national budget for the year of 2000.

Facts and Figures

Speaking to the parliament on the issue of the 2000 national budget, chairperson of the Budget Committee Yulia Tymoshenko, formerly one of Ukraine's most successful businesswomen and top executive of the country's once powerful gas trader, the United Energy Systems of Ukraine, announced that she was presenting the result of six weeks' effort, summarizing over 800 proposals and comments to the initial draft and resulting in radical revision of the government's document. According to Mrs. Tymoshenko, her draft was designed to meet the task of finding ways for substantial increase in budget revenue and spending, giving the budget a stronger social security tilt, supporting the "national producers" and compensating Ukrainians for their savings lost in the collapse of the Soviet banking system and hyperinflation. She was quoting "well-founded conclusions of parliamentary experts" as the basis for the Committee's calculations that the 2000 national budget should be increased by 15,008,982 thousand UAH, or 55.7 percent from the initial amount proposed by the government, and reach 42,159,428.7 thousand UAH. According to Yulia Tymoshenko, the increase of the revenue part of the budget to over 42.159 billion UAH next year rather than the 27 billion UAH proposed by the government should be achieved primarily through the collection of debts of energy companies to the budget (11.184 billion UAH), import dues, VAT and excise tax on imported goods (1.078 billion UAH), and channeling 50 percent of profits from state-owned companies and shares into government reserves, expected to bring the budget additional 1.784 billion UAH. She also argued that the amount of 1.5 billion UAH could be raised from the difference between the hryvnya value of the National Bank's foreign currency and gold reserves at the start of the year and now. A certain share of the revenue is expected to come from "planned" fines and penalties for deviation from the current taxation legislation, though the "panning" has been repeatedly criticized as a loophole allowing extortion by taxmen.

Traditionally, Ukrainian budgets have been friendly to "priority branches" like coal mining and agriculture, demonstratively caring about the social security sphere, and hostile to private business. In the 1999 budget, wages, salaries and pensions, as well as other social security benefits were supposed to be covered by means of increasing budget revenue through added taxation pressure on businesses. However, by the end of June the budget was 11.68 billion UAH short of the initial plan. To cope with the wage arrears problem, an emission of up to 2.75 billion UAH in the second quarter of 1999 was chosen as a short-term solution. The amount of cash in circulation increased by 17 percent and continued to grow, a fair share of it kept outside banks and likely to contribute to the growing inflation potential.

The efforts to increase the taxation pressure on businesses to fill the budget usually bring the opposite results. For instance, the fuel crisis, caused by the government's decision to raise import and excise duties on fuels and the regulations that disadvantaged foreign traders and importers, resulted in a "fire alarm" operation undertaken by the government to curb the fuel price jump, and the return of all taxation benefits to the fuel traders.

The main opposition of the parliament's Budget Committee was caused by the government's announcement of the targeted budget surplus of 554.5 million hryvnyas ($121.4 million), or 0.4 percent of the GDP. The Budget Committee's protest was supported by Speaker Oleksandr Tkachenko who announced that budget surplus was "unallowable" under the current conditions of the Ukrainian economy and social sphere. The idea that a surplus of 554 million could help the government to pay debts to its foreign creditors, amounting, together with interest, to over 16 billion UAH (US$ 3.1 billion) was dismissed by Mrs. Tymoshenko as "ridiculous".

According to Finance Minister Ihor Mityukov, `the majority of the proposed changes create a legal chaos in the budget process and the scale and lack of basis for the proposed changes in the revenue side of the budget are a cause for concern.' The changes, proposed by the deputies and summarized by the Budget Committee would be equal to drawing up an entirely new budget, he added. The opinion, apparently, was shared by the Budget Committee and the Speaker himself; hence the draft was returned to a joint government and parliament commission that will work on the document further and submit the draft for a new first hearing.

Several previous budgets were adopted late with unrealistic revenue parts, which resulted in growing budget deficit and sequester of spending. While the parliament and the government have traditionally blamed each other for the adoption of a "bad" budget, Valentyn Symonenko, chairman of the Accounting Chamber, an official body in charge of auditing budget spending, argues the budgets themselves were "normal", but that the negative effect was caused by "privatization" of budget funds by those authorized to manage them in the interests of the society.

Interim Results

The Budget Committee's version of the draft budget contains a number of anti-market and controversial provisions, like, for instance, the expectation that a major share of the budget revenue will be received from enterprises that were expected to begin paying up their debts to foreign creditors, insured and paid by the Minister of Finance. Taking into account the government's previous experience of trying to make corporate state-owned debtors pay their debts, this expectation appears to be unrealistic, particularly in the context of the demand to prohibit the government to guarantee such loans. Furthermore, it is suggested that the amount allocated for the service of the state debts be reduced by 2.385 billion UAH. The "saved" budget funds are expected to be used as special low-interest loans to the "red feudals" of the agrarian sector.

The practice of "barter" and mutually redressed debts appears to be a favored practice and includes fiscal relations between the state and its citizens. Specifically, the chair of the Budget Committee suggested that 4.5 billion UAH, lost by Ukrainians in the state-owned Sberbank be redressed as the payment towards individual consumers' electricity debts. It is also suggested that the Ministry of Finance could be "excused" from timely paying its debts for the state bonds purchased by the National Bank and that the government might refrain from servicing the part of the state debt created as a result of the failure of Ukrainian business entities to repay government-insured foreign loans. According to Mrs. Tymoshenko, cutting restructuring domestic debt held by the National Bank and refusing to repay foreign loans taken on by companies from the budget will allow saving of 5.09 billion hryvnyas on the 2000 debt servicing. She argued that the arrangement would help Ukraine meet other foreign payments more easily. Over US$3.1 billion are due to be paid on the government's foreign loans next year - a huge amount compared to the government-planned revenue part of the national budget, worth about US$5.4 billion (if the hryvnya stays at the five UAH for the dollar rate). The first portion of US$ 750 million is due next March, which may cause a "soft default", i.e., the Ministry's of Finance efforts to restructure the debt. Alternatively, the Ministry of Finance may try to issue new state bonds that will have to be extremely attractive to enjoy any demand.

Meanwhile...

Foreign direct investment (FDI) to the Ukrainian economy remains critically low: since January 1999 the economy has attracted US$ 265 million, 49.5 percent less than in 1998. Since 1992, the total amount of FDI is about US$ 2.9 billion, leaving the government little hope that foreign investors' money would help cure the ailing economy.

Privatization may also prove to be less profitable and far more difficult than budget planners both in the government and the parliament want it to be. Sales of shares of Ukraine's most attractive enterprises, including parts of the country's oil and gas complex, pipelines, the Lysychansk oil refinery, the Mykolayiv Aluminum Plant, energy distributing companies and the country's telecommunications monopolist, Ukrtelecom, are likely to be complicated by clashes of powerful business interests within and outside this country. The process may be further damaged by the left-wing opposition to privatization in general, and, if the incumbent president remains in office, to him and his government in particular.

Meanwhile, the national currency, hryvnya, that for a while used to be practically the only symbol of successful reform, has dropped from about 3.4 to the dollar in January 1999 to just above 4.6 or 4.95, under the commercial exchange rate, and the exchange rate is likely to continue decreasing. Since January 1999 GDP has reduced by 2%, while the amount of hryvnya cash in circulation grew by almost 30%, particularly in connection with the need to pay wage and pension arrears before the presidential election. According to the Ministry of Finance, in the third quarter of 1999 the government and local budgets paid 1.38 billion UAH as social security transfers towards their 9-billion domestic debt. About half of the amount was provided by the emission of the National Bank. With hard currency reserves of only US$ 1.6 billion, NBU governor Victor Yushchenko had to admit that Ukraine's central bank did not have effective instruments to counter the massive increase in demand for dollar cash.

No matter who becomes Ukraine's next president, Ukraine is facing a challenge of adopting a realistic "low-income" budget and curbing the practice of "soft budget constraints" for pet enterprises and branches. Otherwise getting much-needed cash in loans from the International Monetary Fund and World Bank, even though the country does pay its foreign creditors next year to maintain its credibility with other creditors, may become problematic.

Instead of Conclusion

The previous budget was approved on the New Year's eve. This budget, at best, will be adjusted by the joint governmental and parliamentary commission and submitted for the first reading again in two weeks. The government's perspective on the budget may undergo substantial changes connected to the presidential election outcome, but the immediate results of using the budget for election purposes are already obvious and will continue to put pressure on the new budget. The failure to match the increasing "pre-election" social security obligations and the shrinking base of budget revenue, and simultaneously to pay up the foreign debt, resulted in the growth of domestic debt. The efforts to conceal the growing budget deficit and cover at least some of wage and pension arrears resulted in cash emission, which is likely to result in inflation and subsequent price rise.